GLOBAL *dispatches...*

Basel Group to Recommend Specific Ceilings on Loans

By JOHN EVANS

LONDON — Seeking to avoid excessive concentration of lending risks, the Basel Committee of banking supervisors plans to recommend specific ceilings on how much banks can lend to customers.

These limits will be based on between 10% and 40% of a bank's total capital made in the form of loans to "private-sector nonbanks," mainly corporate clients.

This proposal emerged from a meeting of the Basel Committee in Frankfurt, Germany, this week during the sixth international conference of banking supervisors.

Huib Muller, the Dutch central banker who chairs the Basel Committee, said Friday that a 25% limit on capital was the "preferred midpoint" between the 10% and 40% bands.

Proposals Endorsed

Mr. Muller said the Frankfurt conference had provisionally endorsed the committee's proposed recommendations.

"The plans for a maximum have now been presented to the supervisors, who will get about half a year to react to them," he said. A final version of the current draft paper would be published early next year, he added.

Special consideration should also be paid to loans to groups of companies in one industry sector, Mr. Muller said. This group of loans should be subject to much stricter guidelines, a move regulators privately said underlined concern about large real estate exposures in the banking system.

No Word on Capital Rules

Mr. Muller did not say whether the committee had taken any accommodative action to ease the current Bank for International Settlements' capital adequacy guidelines, under which capital should be equal to at least 8% of total assets. The committee was scheduled to examine whether extra classes of securities could be counted as capital under the Basel accords because of pressure on Japanese and some U.S. banks.

However, he confirmed that the committee was preparing proposals for the supervision of banks and securities firms' business involving price fluctuations in the capital, money, currency, and share markets.

These proposals will be presented to banks and securities houses, as well as supervisory authorities in the leading industrial nations, for their assessment next year.

... by country

JAPAN

Mitsui Taiyo Kobe Bank is planning to disperse 20 to 30% of its headquarters staff to 620 local branches to increase its emphasis on retail banking, a bank spokesman said.

Taiyo Kobe Bank and Mitsui Bank merged on April 1 and now have three major offices in Tokyo and in Kobe with total headquarters staff of about 6,000, he said.

SOVIET UNION

The first Soviet commercial bank to be controlled by Communist Party workers has been set up in Leningrad, a communist official said Friday.

Arkady Krutikhin, general administrator of the regional Leningrad Party Committee, told reporters the bank was being established on orders from the party's central committee.

Mr. Krutikhin said he was named chairman of the new bank, to be called Bank Rossiya.

The bank will start operations with a capital base of $5.1 million at the official exchange rate, drawn from the party's dues and budget, Mr. Krutikhin said.

Bank Rossiya plans to finance restoration projects by the city of Leningrad, the country's second-largest city, whose streets and buildings are badly in need of repair.

According to Mr. Krutikhin, the bank will also finance joint ventures organized by the Communist Party.

A large number of privately owned commercial banks now operate in the Soviet Union.

THE PHILIPPINES

A leading Philippine senator has accused the International Monetary Fund of trying to keep the heavily indebted country in financial bondage.

Senator Wigberto Tanada called for the Philippines to adopt a nationalist economic policy that would build up industries behind a protective tariff wall, instead of agreeing to an IMF program dominated by debt repayment and trade liberalization.

"More and more Filipinos are beginning to see that the real intention behind these policies is to keep the country perpetually in financial bondage," Mr. Tanada told a group of financial executives in a speech.

"We need not get stuck with the IMF program of a debt-fueled, import-intensive, export-oriented, cheap labor-based, agro-industrial development," Mr. Tanada said.

He said it was imperative for the Philippines to maintain a policy of protectionism, which he said was the way South Korea and Japan built their economies.

The *by country* briefs were supplied by Reuters.

Brazil Debt Talks Near Stalemate

Session Ends with No Progress on Payment Schedule

By JAMES R. KRAUS

NEW YORK — Setting the stage for an early stalemate, U.S. and other banks rejected last week Brazil's proposals for massive cuts in interest payments and demanded that the country pay at least a portion of its arrears before talks can continue.

"Clearly, [the proposals] are not acceptable to us," said a senior banker who participated in three days of talks with Brazilian negotiators that ended Friday.

Jorio Dauster, Brazil's top negotiator, rejected last week any payment of interest arrears to banks until after an agreement is reached with banks.

Pressure on the IMF

However, senior bankers close to the negotiations said that banks would press the International Monetary Fund to withhold disbursing a $2 billion bridge loan to Brazil if the country does not begin repaying $8 billion worth of interest arrears it has accumulated since July 1989.

Fund officials said last month they would not release the $2 billion bridge loan until Brazil reaches substantial progress in talks with banks, while banks have threatened to further reduce some $11 billion in short-term trade lines to Brazil if the talks fail.

The talks were part of an initiative launched by U.S. Treasury Secretary Nicholas F. Brady in March 1989 to reduce the foreign commercial debt of troubled Third World countries.

Profit Drain
Medium- and long-term loans to Brazil

	$ in millions
Citicorp	$2,700
Chase Manhattan	1,361
BankAmerica	1,300
Manufacturers Hanover	1,026
J.P. Morgan	923
Chemical Banking	819
Bankers Trust	607*
First Chicago	209
Continental Bank	176
Bank of New York	18

*Figure represents total exposure
Source: Keefe, Bruyette & Woods Inc.

Agreements Reached Elsewhere

Agreements have already been reached with Mexico, the Philippines, Costa Rica, Morocco, and Venezuela. A sixth debt reduction agreement is being negotiated with Uruguay.

In the past three years, Brazil has cut between $10 billion and $12 billion from some $60 billion in medium-term and long-term debts it owed foreign commercial banks by buying back the debt on secondary markets or converting it into domestic bonds or equity.

Negotiations are focusing on how to reduce the $45 billion the country still owes foreign banks and some $4 billion more acquired by Brazilian banks.

In a departure from previous debt reduction agreements, Brazil proposed Thursday to drastically slash the interest and extend the maturities on tens of billions of dollars it owes foreign commercial banks without providing banks with any guarantees for repayment.

Senior bankers in New York said Friday that two of the three options Brazil proposed call for cuts in interest payments of more than 50%.

A third proposal calls on banks to consolidate Brazil's interest arrears and principal into 45-year zero-coupon bonds.

Zero coupon bonds pay principal and interest in one lump sum when bond matures.

Bankers said Friday that they found the proposals confusing and viewed them as no more than an opening round in what promises to be extended talks.

The 22 banks on the Brazilian bank advisory committee are scheduled to meet this week to go over economic data supplied by Brazil and draw up their own proposals for a debt reduction package. □

Hongkong and Midland May Delay Merger

By JOHN EVANS

LONDON — The planned combination of Midland Bank PLC and Hongkong & Shanghai Banking Corp., a linking that would form one of the world's top 10 banking companies, has reportedly been delayed because of souring lending business at both companies.

The alliance had been depicted by the two partners as creating a new global superbank, combined Hongkong Bank's Asian business and the European organization of Midland, Britain's fourth-largest bank.

In the United States, the alliance was scheduled to center largely on Marine Midland Banks Inc., Hongkong Bank's American subsidiary.

A spokesman for Midland declined to comment Friday on a report, in the *Financial Times,* that the alliance had been postponed because of difficulties facing both groups. Industry analysts expressed little surprise.

Both banks have been adversely affected by economic downturn in the United States, Europe, and Asia. In the first six months of 1990, Midland's trading earnings before bad and doubtful debts fell 20% to $707 million while Hongkong Bank's net earnings fell 20% to $197 million.

Midland's chairman, Sir Kit McMahon, has previously indicated a delay is possible, said Alison Deuchards, banking analyst at Smith New Court, a London brokerage firm. The essence of the published report was "made very clear" when the Midland officer announced the bank's second-quarter earnings, she noted.

Hongkong Bank owns 14.9% of Midland, a stake it has previously pledged not to increase until after a standstill agreement runs out Dec. 22.

The *Financial Times* said the banks would extend this agreement while at the same time reaffirming their plans for an eventual combination.

Christopher Wheeler, an analyst at Shearson Lehman Hutton, London, said a formalized standstill agreement may now be seen as unnecessary. □

Key International Rates*

	Day-to-day money			3-mo. interbank			6-mo. interbank			Discount rate			Prime equivalent		
	10/12	10/11	10/5	10/12	10/11	10/5	10/12	10/11	10/5	10/12	10/11	10/5	10/12	10/11	10/5
United States	8.06	8.13	8.19	8.25	8.25	8.19	8.25	8.25	8.19	7.00	7.00	7.00	10.00	10.00	10.00
Japan	7.75	7.75	7.69	8.33	8.32	8.32	8.38	8.45	8.44	6.00	6.00	6.00	7.38	7.38	7.38
Canada	12.95	N.A.	N.A.	12.90	12.90	12.07	12.25	12.25	11.94	12.59	12.59	12.59	12.75	13.75	13.75
U.K.	13.87	13.88	13.00	13.68	13.82	13.88	13.44	13.44	13.50	N.A.	N.A.	N.A.	14.00	14.00	14.00
Germany	8.25	8.13	8.32	8.63	8.63	8.63	8.81	8.13	8.81	6.00	6.00	6.00	10.50	10.50	10.50
Switzerland	7.75	7.75	7.34	8.06	8.06	7.94	8.25	8.25	8.19	6.00	6.00	6.00	9.88	9.88	9.63
France	10.00	10.00	9.34	10.38	10.38	10.18	10.56	10.56	10.35	9.50	9.50	9.50	10.50	10.50	10.50
Italy	10.75	10.88	11.00	10.94	11.13	10.37	11.32	11.44	10.37	12.50	12.50	12.50	13.00	13.00	13.00

Forward Rate Agreements

	U.S. dollars	Sterling	West German marks	Swiss francs	Yen
3 to 6 months	7.94	12.85	8.72	8.23	8.32
6 to 12 months	8.01	11.90	8.96	8.13	8.40
12 to 24 months	8.84	11.12	9.23	9.15	8.18

* Midday quotes in the New York market

Source: Noonan, Astley & Pearce Inc., New York

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TOP MORTGAGE SERVICING COMPANIES
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VOL. CLV NO. 201 *Tuesday, October 16, 1990* *155th year*

Marketers Slow To See Potential Of Image Systems

By KAREN GULLO

Although many banks plan to invest millions of dollars in imaging systems, bank marketing executives remain skeptical about the technology's benefits.

Bank technologists have long touted image-based processing systems as vehicles not only for cutting back-office costs, but also for gaining market share through new products. A recent study, however, reveals their marketing brethren are not so sure.

The study, which was based on a poll of 50 marketing executives from banks chosen at random by Trans Data Corp., an affiliate of the *American Banker*, indicates that marketers are either unaware of imaging's potential benefits or unconvinced that customers will want image products, such as monthly statements with miniature copies of check images.

ANALYSIS: *Follow-up on the news*

That assertion flies in the face of previous studies, which indicate that consumers prefer monthly image-based statements to conventional ones with returned checks.

Lack of Inclination Seen

"What we see is a gap in communications," said Steven D. Matzke, document processing program manager at Trans Data. "Normally, operations and marketing go hand in hand, but this study says that the marketing side hadn't found the time or inclination to learn about consumer acceptance of image products."

Although only a couple of banks offer image-based account statements now, Fleet/Norstar Financial Group Inc., Mellon Bank Corp., Security Pacific Corp., and other large institutions are planning to do so. American Express Co. is the most well-known provider of image-based statements in the financial arena.

Widespread Skepticism

Despite such plans, half the marketers in the Trans Data survey said they believe imaging presents no significant marketing opportunities. While many respondents say imaging is cost effective for back-office operations, only 3% think the technology has the potential to increase fee income and improve customer service or convenience, the survey found.

Only 17% believe that a majority of their customers will

See **MARKETERS** *page* **3**

INSIDE NEWS

EARNINGS

J.P. MORGAN reported earnings of $208 million in the third quarter, virtually flat with its results in the preceding three months. Chase Manhattan lost $623 million, largely because of a $1 billion outlay for a reorganization and potential loan losses. *Page 2*

THE RTC

REP. HENRY GONZALEZ is ready to let the Federal Savings and Loan Insurance Corp. Resolution Fund borrow directly from the Treasury to renegotiate 1988 thrift deals. *Page 2*

FINANCE

ELF ACQUITAINE, the big state-owned energy company in France, received favorable terms recently on a $1.36 billion financing to develop North Sea oil fields. *Page 30*

SOCIETY CORP., the Cleveland-based superregional banking company, came through the recent debacle in bank stocks in better shape than its local competitors. *Page 32*

INTERNATIONAL

FIVE MAJOR BRITISH banks are being blackmailed by a group of hackers who have broken into their central computer systems, according to reports from London. *Page 27*

CONSUMER

DESPITE AGGRESSIVE marketing efforts by banks and other lenders, only 13% of consumers said they have a home equity line of credit, according to the 1990 *American Banker* consumer survey. *Page 12*

TECHNOLOGY

MOST LARGE U.S. banks are using branch automation technology merely to give the appearance of better service, rather than to provide real value to customers by reducing costs, according to a recent study. *Page 3*

COMMENT

FORWARD-LOOKING banks are now analyzing returns in each of their constituent businesses, writes Sanford Rose. *Page 4*

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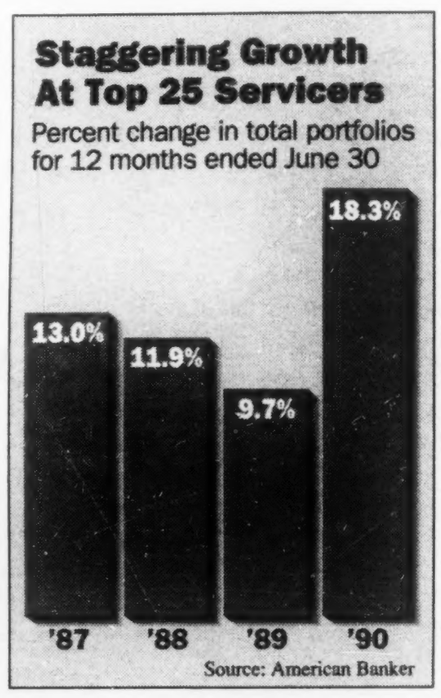


Business Booms For Top Firms in Mortgage Service

By PHIL ROOSEVELT

NEW YORK — Undaunted by a weak economy and a housing slump, the nation's top mortgage servicers have been growing at a breathtaking rate.

The 25 largest servicers – banks, thrifts, and mortgage companies – increased their portfolios by 18% in the 12 months that ended June 30, an *American Banker* survey shows. That was well ahead of both the 7.5% rise in total mortgage debt outstanding and the 9.7% growth posted by the top servicers in the previous 12 months.

Sharp Increases

Complete tables , including rankings of the top 300 mortgage companies in servicing, the top 100 banks, and the top 50 thrifts,

See **MORTGAGE** *page* **19**

SecPac and First Chicago Boost Loan-Loss Reserves

By TERESA CARSON
and NANINE ALEXANDER

Security Pacific Corp. and First Chicago Corp. reported on Monday sharply higher loan-loss provisions in the third quarter, leading to lower-than-expected profits.

Los Angeles-based Security Pacific said its earnings fell 27% to $135.3 million, or $1.05 per share, after adding $240.9 million to its loan-loss reserve. Analysts had expected the banking company to earn about $150 million.

First Chicago Corp. said it earned $36.2 million, or 45 cents a share, after almost doubling its provision for loan losses to $160 million. The results were far below the $60 million analysts had projected.

Loan Woes Spurring Large Provisions

	3Q provision ($ in millions)	Increase from 2Q
Chemical	$250.0	205%
Chase	$650.0	189%
Barnett	$100.7	116%
First Chicago	$160.0	88%
Southeast Banking	$115.0	84%
Security Pacific	$240.9	50%

Source: Company reports

The stocks of both banking companies rose on the news. First Chicago Corp closed up 75

See **SECPAC** *page* **10**

Funds Costlier for Japan's Banks

By JOHN EVANS

LONDON — As the flight to quality in international banking spreads, Japanese banks are being forced to pay substantial interest rate premiums for their short-term funding overseas.

The banks are paying an eighth to a quarter of a percentage point more than their U.S. and European competitors in the Eurodollar interbank market and the markets for Eurodollar certificates of deposits and commercial paper, European monetary sources say.

The rate premium will add hundreds of millions of dollars to their capital costs and could further blunt their global lending capability, the sources say.

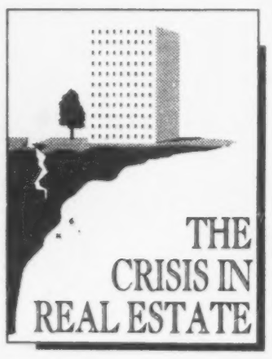
"The Japanese banks are being squeezed as investors reduce their lines, cutting their overall exposures from the large levels in the past," said Len Harwood, money markets director for Union Bank of Switzerland in London.

The demand for greater compensation for lending to the Japanese reflects concerns over banking stability and credit quality in Japan after the 40% plunge in the Japanese stock

See **JAPANESE** *page* **26**

Shell Shock in the Realty Department

By JED HOROWITZ
Second of a Series



In Boston, veteran real estate banker Brian Sopp had tickets to the Red Sox-Oakland A's playoffs and no clients to share them with.

"There's no one I needed to or wanted to give them to," says Mr. Sopp, the head of U.S. Trust Co.'s real estate department. "We aren't looking for new business."

In New York, a lender-turned-workout specialist grouses about longer hours, extensive paper pushing, and bosses too frightened of regulators to make decisions.

"You're doing a story on the human side in real estate banking?" the banker says, demanding anonymity. "That's funny. This is the stage of the game where your reward is simply to stay employed."

Stuart Goldenberg

Sleepless Nights

Real estate lenders around the nation are not a happy lot. As they help their banks tunnel out of an avalanche of bad loans, they are restless, scared, and defensive. They speak of endless documentation, battles with borrowers who used to be their

See **REAL ESTATE** *page* **14**

COMMENT / *By Sanford Rose*

The Managerial Imperative

A growing number of banks are switching from a return-on-assets to a return-on-equity measure of performance. The reason is abundantly clear: The stock market is less interested in the ROAs of banks than in their risk-adjusted ROEs. The shareholder wants to know whether his bank is making more or less on his money than can be obtained from other investments of comparable riskiness.

High ROAs may translate into low risk-adjusted ROEs if they are derived from businesses whose riskiness is such that the bank must backstop them with inordinate amounts of shareholder money.

For example, banks whose principal activity is middle-market corporate lending may earn exceedingly high ROAs and net interest margins, at least for a while. But since the amount of equity required to sustain this business, given its vicissitudes, is generally quite large, the risk-adjusted ROE may be, and in most cases is, unacceptably low – often lower, in fact, than the return the shareholder can make in comparable-risk activities.

The reason, quite simply, is that the banks do not, or cannot, price high enough to cover the risks and therefore pay for the capital needed to support the middle-market lending business. Hence, despite temporarily high nominal returns, many middle-market lending banks limp along with quite depressed stock valuations.

Identifying the Independent

As banks increasingly appreciate the need to satisfy the requirements of a forward-looking marketplace interested in sustainable equity returns, they are analyzing each of their constituent businesses on an unbundled, or stand-alone, basis. The analytic process embraces three steps: first, determining what constitutes an independent business; second, assigning an appropriate market-determined hurdle rate of return on equity to the independent business; and third, determining the amount of capital that is economically necessary to support the business.

Each of these steps involves an intense amount of cogitation and practical judgment. For example, what is an independent business? In the retail area, is deposit-taking such a business? Or should a bank's deposit-taking activities be combined with other branch-related businesses for purposes of profitability analysis?

Vanward banks are now analyzing returns in each of their constituent businesses.

Once a bank identifies its truly independent businesses, it must determine an appropriate hurdle rate for each. According to modern financial theory, the acceptable hurdle rate is equal to the riskless T-bill rate plus a "beta" or premium for the business' individual riskiness times the excess return customarily demanded by the typical investor for being in risky stocks rather than riskless bills.

Two of the three components of this hurdle-rate formula are reasonably easy to assess – the bill rate and the excess return. The problem, of course, is to figure out the beta for the business in question.

The beta of a business is a measure of its earnings volatility relative to that of the general marketplace. In an article forthcoming in the winter issue of the *Journal of Retail Banking*, Price Waterhouse offers the following commonsensical advice on calculating betas.

"To choose a beta, you first collect information on actual betas from stand-alone institutions operating in similar businesses. (For example, the betas for independent mortgage banks typically range from 0.6 to 1.1.) For other businesses, proxies can be used. In the more broadly defined retail branch businesses, we have used a proxy of 0.5 to 0.9 derived from smaller regional banks that primarily focus on retail and small commercial lending.

"For other businesses, few beta proxies exist. In these cases we recommend that the bank first analyze the returns on equity for the business over a five- to 10-year period. The standard deviation of ROE (the square root of the variance from the mean) in the business can then be compared with the standard deviation of the overall bank ROE. For example, if the standard deviation of returns in a retail business is 1% and the standard deviation of the overall bank's returns is 2%, then the beta proxy for that business is 0.5."

If the beta for the business indeed amounted to only 0.5, then the required rate of return on shareholder's equity is readily calculable. If the T-bill rates averaged 7.5% over some meaningful period of time and the excess market return averaged 8%, then the minimum after-tax rate of return on the business amounts to 11.5%. This is low for most bank businesses, but then most business betas are higher than 0.5.

Creating the Capital Cushion

Of course, in order to compare the standard deviations of returns, as suggested by this method, one first has to establish bona-fide ROEs. The bank's overall ROE is known, but the ROE of a component business depends on the amount of its allocated or imputed capital. Hence, determining the beta and therefore the hurdle rate of return for a business in many cases presupposes an analysis of its economically needed capital cushion. For many lending businesses, the capital cushion is dictated, or at least heavily influenced, by the risk-based regulatory guidelines. (As this writer tried to demonstrate in his article of Sept. 25, banks should not slavishly follow the regulatory framework.)

But what about businesses not covered by the capital rules – e.g., fee-based or deposit-based businesses? The amount of capital required should of course be related to the worst-case scenario for potential losses, which would probably require the bank to allocate enough equity to cover two standard deviations from mean earnings performance, or 95.5% of the historic negative deviation from average profits.

On the assumption that maximum losses in most fee-based or deposit-based businesses are usually no greater than one year's operating expenses, Price Waterhouse recommends that banks earmark capital equal to this amount.

Projecting Cash Flows

Having identified those businesses that qualify as stand-alone entities, the appropriate hurdle rate of return on equity for each, and the amount of economically needed capital, a bank is prepared to undertake an analysis of value-creating or value-destroying properties.

The technique to be employed is discounted cash flow. The bank must project net cash flows – interest and noninterest revenues less match-funded interest expenses, noninterest expenses, loan losses, and taxes. It must also assign a terminal value to the business.

It must then discount the net cash flows and the terminal value to their present worth, using the aforementioned hurdle rate of return. If the amount of these net flows, appropriately discounted, exceeds the amount of the economically needed capital, the business is an acceptable contributor to shareholder value. It is earning more than the shareholder's cost of equity – the return that investors can expect from other businesses of similar riskiness.

If the discounted present worth falls short of the needed capital, the business is at best a candidate for restructuring and at worst a candidate for divestiture.

Difficult as the above analysis may appear, the best-managed banks have either already done it or are considering doing it. They simply have no alternative if they wish to remain viable competitors for investment capital. □

COMMENT / *By Anat Bird*

Regulation Isn't the Only Problem

It is becoming increasingly apparent that American banks are having difficulties maintaining their position as major international competitors.

There is no American bank among the top 10 banks in the world, and only one is in the top 25. Our international involvement resulted in a credit disaster – lesser-developed-country loans – and other failures at profitable entry into global financial markets.

Even our leading bank, Citibank, which unlike most of its peers has not backed away from its global presence and commitment, is experiencing difficulties.

The explanation often offered these days is the lack of regulatory parity between the United States and our primary competitors in the Group of Seven industrial countries and Switzerland.

We are told that our regulatory structure is much more restrictive and burdensome than that of our competitors, leaving U.S. banks at an unfair disadvantage.

Although this is to a great extent true, I believe there are many other important reasons for our inability to successfully compete in global markets.

Two questions are at hand:

- Is there regulatory disparity that has a material impact on our ability to compete?
- Are there other, equally important reasons why U.S. banks are not doing as well as they should globally?

Weighing the Burden

The weight of relative regulatory burden across countries can be examined by looking at legal reserve requirements, regulatory structure and reporting requirements, liquidity requirements, capital requirements, and deposit insurance/safety net. Other categories worth looking into are taxes, subsidized advances,

scope of powers, compliance regulations, social programs, and litigation and legal costs.

The American Bankers Association has conducted analyses of these components. It appears that the American banking system exhibits significant disadvantages relative to other developed countries' systems.

Some restrictions are obvious. For example, the Glass-Steagall Act, which separates commercial and investment banking, is uniquely American. No such separation exists in the other countries evaluated.

Foreign Banks' Advantages

Further, banks outside the United States are permitted to

See **REGULATION** *page* **29**

Ms. Bird is director of financial-institutions consulting at BDO Seidman.

AMERICAN BANKER

Established 1836
One State Street Plaza, New York, N.Y. 10004
212-943-6700

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(ISSN No. 0002-7561)
Postmaster: Send address changes to American Banker, One State Street Plaza, New York, N.Y. 10004
Subscription Rates: U.S. $635 a year, Canada $815. Canada Airmail and Foreign $1,120. Single copies: $5.75. Special issues: $25 or $55. Back-issue prices based on date of publication.
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